No. 227

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

THOMAS W. STREETER, *et al.*,
Petitioners,

v.

CENTRAL-ILLINOIS SECURITIES CORP., C. A. JOHNSON, LUCILLE WHITE, and FRANCES BOEHM.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

LAWRENCE R. CONDON,
Attorney for Petitioners,
Thomas W. Streeter, et al.,
preferred stockholders of
Engineers Public Service
Co.,
165 Broadway,
New York 6, N. Y.

LAWRENCE R. CONDON,
MILTON MAURER,
Of Counsel.

THE COURT PRESS, N. Y. C.

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CENTRAL-ILLINOIS SECURITIES CORP., C. A. JOHNSON, LUCILLE WHITE, and FRANCES BOEHM.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

Thomas W. Streeter, *et al.*, the petitioners herein, pray that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Third Circuit vacating the decree of the United States District Court for the District of Delaware with directions to enter an order disapproving the plan as not being fair and equitable within the purview of section 11(e) of the Public Utility Holding Company Act and to remand to the Securities and Exchange Commission which had approved the plan.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 12) and the opinion denying the prayers of the petitions and cross-petitions for rehearing (R. 138) have not yet been reported. The opinion of the District Court (R. 238a) is reported in 71 F. Supp. 797. The findings and opinion (R. 25a) and supplemental findings and opinion of the Securities and Exchange Commission (R. 128a) have not yet been officially reported but are set forth in the Commission's Holding Company Act Releases Nos. 7041 and 7119, respectively.

Jurisdiction.

The judgment of the Circuit Court of Appeals (R. 41) was entered on March 19, 1948. A petition for rehearing (R. 140) was denied on June 11, 1948. The jurisdiction of this Court is invoked in section 240 of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. §347) and made applicable by section 25 of the Public Utility Holding Company Act of 1935 (15 U. S. C. §79y).

Statute Involved.

Section 11(e) of the Public Utility Holding Company Act of 1935 [15 U. S. C. §79k(e)] provides as follows:

> "In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control,

securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."

Section 24(a) of the said Act [15 U. S. C. §79x(a)] provides as follows:

"Any person or party aggrieved by an order issued by the Commission under this chapter may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his prin-

cipal place of business or in the United States Court of Appeals for the District of Columbia by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, or upon any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any for the modification or setting aside of the original order. The judgment and decree of the court

affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended [28 U. S. C. §§346 and 347]."

Questions Presented.

The holding company which is being liquidated in compliance with section 11 is solvent. Under its charter, the three classes of preferred stock have a call or redemption price higher than their (involuntary) liquidation preference. Each of the three classes of preferred shares has an investment value at least equal to the call price. The following questions are presented:

1. Did the Commission properly apply the "fair and equitable" standards of section 11(e) of the Public Utility Holding Company Act as interpreted in *Otis & Co.* v. *S. E. C.*, 323 U. S. 625, in approving a plan which would pay the preferred stockholders cash equal to the current going concern value of their shares but not in excess of the call price, where this amount exceeds the (involuntary) liquidation preference of such shares under the charter?

2. Where preferred stockholders are accorded the going concern value of their rights surrendered in the liquidation of a holding company pursuant to section 11(e) of the Public Utility Holding Company Act, is the Commission required to reconstitute the history of the company so as to determine whether there have been any losses as a result of divestments or other action taken by the common stock management by reason of the Act, with a view to charging those losses in whole or in part to preferred stockholders?

3. Where a plan under section 11(e) of the Public Utility Holding Company Act satisfies a preferred stockholder's senior claim in cash and the Commission (a) equates the cash received to the value of the interest surrendered by the preferred, and (b) finds that the residual common stock interest is benefited through the retirement of the preferred and that the plan is fair to the common stockholders, is the Commission required to put a cash value on what the common stockholders should receive and surrender?

4. Where a plan under section 11(e) of the Public Utility Holding Company Act is sought to be enforced in a district court and there is no dispute as to the sufficiency of the evidence upon which the Commission based its finding of fairness, is the court authorized to reject such finding on the basis of a discretionary weighing of alleged equities without reference to the limitations upon the scope of judicial review which this Court has held apply to a circuit court of appeals in direct review of a plan under section 24(a) of the Act?

5. Is the scope of review by a district court which has been requested to enforce a plan approved by the Commission pursuant to section 11(e) of the Public Utility Holding Company Act so broad that the district court may substitute its judgment as to the fairness of the plan for that of the Commission?[1]

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[1] Questions 1-4 have been substantially adopted from the statement of questions in Commission's petition for writ of certiorari. In addition, if certiorari is granted, we shall also argue (1) that the retirement of the preferred stock was voluntary within the meaning of the charter and that therefore the voluntary liquidation preferences were controlling, as an alternative to question 1 above; (2) that where the undisputed investment values are greater than the voluntary redemption prices but the Commission restricts the participation of senior security holders

[Footnote continued on following page.]

Statement.

History of Proceedings.

A proceeding was instituted in the United States District Court for the District of Delaware by the Securities and Exchange Commission ("the Commission") pursuant to sections 11(e) and 18(f) of the Public Utility Holding Company Act of 1935 ("the Act")[2] to effectuate a section 11(e) plan of liquidation and dissolution filed by the Engineers Public Service Company ("Engineers")[3] with the Commission, which plan, as subsequently amended, was approved by that body on January 8, 1947 (R. 141a).

On May 15, 1947, the district court filed an opinion (R. 283a) approving the plan except as to that por-

[Footnote continued from preceding page.]

to amounts equal to the call prices fixed in the Company's charter, the plan is not fair and equitable which permits termination of the dividend rights of those security holders while the common stockholders are contesting the payment of the aforesaid full amounts; (3) that the modification or amendment of the plan to provide for the deposit in escrow of the difference between the stated values and the respective call prices of the preferred was improper as it was accomplished without notice and an opportunity to be heard in disregard of pertinent provisions of section 11(e) of the Act.

[2] Act of Aug. 26, 1935, c. 687, Title I §33; 49 Stat. 838, 15 U. S. C. §§79-79z-6, §79k in particular.

[3] Engineers was incorporated in Delaware in 1925 (R. 1403a) primarily to acquire and own public utility properties. The Engineers' system which was put together by Stone & Webster, Inc., an engineering firm, sprawled over many states and was composed of a great many separate corporate entities. Although there were over 12,000 common stockholders, 338 or 2.52% of them owned 72.54% of the stock and of this amount the greatest number of shares was owned directly or indirectly by members of the Stone and Webster families (R. 567a-570a).

tion of it which proposed to retire the outstanding three series of preferred stocks at amounts equal to the respective call prices fixed by the charter (R. 292a). The district court found the preferred stockholders entitled to only $100 per share—the amount specified in the charter as payable in the event of involuntary liquidation. On May 29, 1947, the district court entered its order adopting certain changes in the plan, including the creation of an escrow of the amount in excess of $100 per share and directing the retirement of the preferred stocks at $100 per share and the immediate consummation of the plan as so changed.

On May 29, 1947,[1a] the petitioners filed their appeal from the district court order in the Circuit Court of Appeals for the Third Circuit from which order appeals were also subsequently taken on behalf of the Commission and the Home Insurance group of preferred stockholders. On March 19, 1948, the Circuit Court of Appeals filed its opinion (R. 12), affirming the decision of the district court that the plan as submitted by the Commission was unfair and inequi-

[1] The applications by the petitioners herein for a stay of this order of consummation, pending appeal, were denied in turn by the district court on May 29, 1947 (R. 335a), by the United States Circuit Court of Appeals for the Third Circuit on June 2, 1947 (R. 14) and a Justice of the United States Supreme Court on June 4, 1947. Since then the plan has been consummated except for the distribution of the fund deposited in escrow pursuant to the district court order (R. 39-40).

[1a] One of the petitioners herein is Thomas W. Streeter, a director and preferred stockholder of Engineers, who dissented from the initial plan as unfair in its proposal to retire the preferred stock at $100 per share. At Streeter's insistence the Board of Directors authorized the preferred stockholders to employ independent counsel to insure that the rights of those stockholders would be adequately represented before the Commission and in the courts (R. 473a).

table and vacating the decree of the district court approving the plan as amended, with directions to enter an order of disapproval and to remand to the Commission for further and appropriate action by it. On June 11, 1948, the Circuit Court of Appeals filed its opinion denying the prayers of the petitions and cross-petitions for rehearing (R. 138).

Proceedings before the Commission.

On September 10, 1945, during the pendency of an action before this Court to test the validity of the Commission's divestment orders under section 11(b)(1)[5] of the Act, the Company filed a plan (R. 1307a) under section 11(e) of the Act which was designed to effect compliance with those divestment orders and which also provided for the elimination of Engineers although such action had not been required by the Commission. This plan was the cul-

[5] On February 21, 1938, Engineers registered with the Commission and on February 28, 1940, the Commission instituted integration proceedings under section 11(b)(1) of the Act. In 1941 the Commission ordered the Company to dispose of its interests in two subsidiaries. The Company did not contest this order. On September 16, 1942, and October 6, 1942, the Commission issued other divestment orders which were set aside by the Court of Appeals for the District of Columbia, the cause being remanded to the Commission. *Engineers Public Service Co. v. S. E. C.*, 138 F. (2d) 936 (App. D. C., 1943) cert. granted, 322 U. S. 723 (1944). Certiorari was granted by the Supreme Court, but disposition was not had because of the lack of a quorum. In the meantime, Engineers disposed of the properties which were the subject of Commission's orders, in the consummation of the plan, approved and enforced by the district court's order dated May 29, 1947, the stay of which, as noted above, had been denied in turn by the district and circuit courts and a Supreme Court Justice. On October 20, 1947, the Supreme Court dismissed the appeals as moot [332 U. S. 783 (1947)].

mination of efforts of management stemming from about 1941, during which period several types of plans were considered and discarded, including distributions in kind, a one stock reorganization, a "package" distribution, a partial payment plan, a voluntary exchange plan, etc.[6] After consultation with the major common stockholders, the primary objective was set at the ultimate elimination of the preferred stockholders from the enterprise so as to give the common stockholders direct ownership of the underlying companies.[7]

Accordingly a plan was fashioned (I) to provide for the immediate retirement of the three series of outstanding preferred stocks[8] at the involuntary liquidation price of $100 per share plus accrued dividends by a deposit of that amount by Engineers in favor of the stockholders, the remaining assets thereafter to be distributed to the common stockholders; (II) to permit the later determination of the question as to whether the preferred stockholders were entitled to any amount in excess of $100; and (III) to eliminate Engineers, either by way of dissolution or by merger with one of its subsidiaries (R. 1310a), the merger alternative being removed by amendment by the company during hearings before the Commission.

On December 4, 1946, the Commission issued its findings and opinion (R. 25a, H. C. A. R. No. 7041), in which it found, among other things, that although

[6] R. 475a, 481a, 482a, 675a, 688a, 689a, 691a, 707a, 709a, 715a, 717a, 718a.

[7] R. 583a, 643a, 687a, 719a, 723a.

[8] $5 series, $5.50 series and $6 series. Engineers had no debt. The pertinent charter provisions are set forth at R. 1412a.

the plan was necessary to effectuate the provisions of section 11 of the Act, it was unfair to the preferred stockholders in its proposal to retire their stock at $100 per share. The Commission was of the view that under the principles enunciated in *Otis & Company* v. *S. E. C.*, 323 U. S. 624 (1945), the preferred stockholders were entitled to the current investment value of their securities and that such value was at least equal to the respective call prices of the three series of outstanding preferreds, namely, $105 for the $5 preferred and $110 for both the $5.50 preferred and $6 preferred. The Commission reached this conclusion after (a) consideration of "all provisions of the charter applicable to the preferred, such as the dividend rate and the call price, as well as the liquidation preferences", (b) analysis of "the financial condition of the company, with particular regard to the asset and earnings coverage of the preferred" (R. 62a), and (c) reference to the undisputed testimony of both the preferred stockholders' and the Company's witnesses that the intrinsic values of the preferred were considerably in excess of the call prices (R. 67a). However, the Commission was of the opinion that the call prices placed a ceiling on the right of the preferred to participate in the distribution of the assets (R. 67a).

The Commission stated, also, that it would approve an amendment to permit the deposit in escrow of the amount in excess of $100 per share in the event of further litigation as to the rights of the preferred stockholders (R. 75a). The Commission indicated that the plan would be disapproved unless it were amended to provide for retirement of the preferred at amounts equal to their respective call prices (R. 73a, 299a).

Within the time specified, Engineers filed an amended plan proposing to retire the preferred at amounts equal to their respective call prices (R. 102a). On January 8, 1947, the Commission issued its supplemental findings and opinion and order among other things (a) approving the plan as amended, (b) directing its counsel, in accordance with Engineers' request, to proceed with court enforcement, and (c) finding it fair and equitable to provide an escrow arrangement subject to the enforcement court's jurisdiction in the event of delay due to further litigation (R. 128a, 141a).

Court Proceedings.

In accordance with the Commission's direction, an application (R. 4a) was filed on January 9, 1947 with the United States District Court for the District of Delaware. During the pendency of the aforesaid application, the Commission, pursuant to a request by the President of Engineers (R. 271a, 394a), entered without notice to the preferred stockholders or an opportunity to be heard thereon a so-called order of amendment[9] on February 11, 1947 (R. 165a) permitting the consummation of the plan by an alternative method through the use of an escrow.

On May 15, 1947, the district court filed an opinion in which it concluded "that because of the provision for payment of premium, the plan does not meet the requirements of fairness and equity. With the exception of the payment of redemption premiums, the plan is approved including the Escrow Agreement" (R. 292a). It was the district court's view that a "§11(g) court has the affirmative and independent

[9] It is the Commission's view that the Order of Amendment did not constitute an amendment to the plan (R. 166a, 389a).

duty to consider and find whether a proposed plan, which has been approved by the Securities and Exchange Commission, is fair and equitable" (R. 286a). Stating that the quantum of participation to be allowed the preferred stockholders under §11 was to be measured by standards of "colloquial equity", the district court found that the investment value of the preferred stock was not controlling but was just one of the elements to be considered and that "after consideration of all factors involved" (including issue price, market history, losses due to divestments, "past sacrifices", etc.), it concluded "that $100. would be fair and equitable, but that the payment of premiums would not be fair and equitable" (R. 288a).

On May 29, 1947, the district court entered its findings of fact and conclusions of law (R. 293a) and an order (R. 318a), among other things, (a) adopting the alternative method of consummation via an escrow arrangement, (b) directing the retirement of the preferred stock at $100 per share [despite the Commission's finding that such treatment was unfair] and (c) the immediate consummation of the plan, except for the proposed allowance of the so-called premium. In accordance with this order, the plan has been carried into effect, except for the distribution of the fund deposited in escrow (R. 39-40).

On the appeals filed by the Commission and the Home Insurance and Streeter groups of preferred stockholders, the circuit court affirmed the decision of the district court that the plan, as approved and submitted by the Commission was unfair and inequitable, and vacated the district court's decree for its error in amending the plan to substitute its own estimates of values and approving and enforcing the plan as so amended. It directed the return of the record

for further and appropriate action by the Commission, the remaining problem being one of valuation. The circuit court also noted that in view of its denial of the Streeter motion for a stay made shortly after the entry of the district court's order of approval and enforcement, the plan had been carried into effect except for the payment of the fund deposited in escrow (R. 39-40).

The rationale of the circuit court's decision hinges primarily upon two concepts—(1) the function of a section 11(e) court, and (2) the standards of valuation for determining equitable equivalents. With respect to the first concept the circuit court after an extensive analysis concluded that a "Section 11(e) court must exercise its full and independent judgment as to the fairness and equity of the plan" (R. 33). The circuit court held that the findings and conclusions of the Commission are not binding upon the district court and expressly refused to apply the substantial evidence rule to a section 11(e) proceeding (R. 33), and also refused to follow the principles that "unless the conclusions of the Commission lack rational or statutory foundation they may not be disturbed by the section 11(e) court, or that a reversal of the Commission's judgment by the court may not be effected save where the Commission has plainly abused its discretion" (R. 34).

In reference to the standards of valuation, the court below held that "all pertinent factors and all substantial equities must be considered by the Commission whether equitable equivalents are to be reached by the approach *ex* the Act or the approach *intra* the Act" (R. 38). It stated that the Commission has "misunderstood the principle of equitable equiva-

lents' enunciated by the Supreme Court in the *Otis & Co.* case"; that "the new doctrine of investment value * * * may not be substituted for the doctrine of equitable equivalents"; and that "investment value is and can be only one of a series of factors to be used in arriving at equitable equivalents" (R. 38, 39). The court below also criticized the Commission for its alleged errors in (a) failing to give adequate consideration to such "equities" and "factors" as losses occurring to Engineers by virtue of the divestitures compelled by the Act, future earning power, etc.; (b) adopting inconsistent techniques in valuing the preferred "*ex* the Act" and the common "*intra* the Act"; (c) making "no finding as to the 'value' of the common stock"; and (d) disregarding the fact that "the holding company enterprise is at an end, both for the preferred and common", which fact (according to the court below) differentiates the instant case from The United Light & Power Company reorganizations (R. 35, 36).

Petitions for rehearing were filed on behalf of the Commission and the Home Insurance and Streeter groups of preferred stockholders for the reason, among others, to obtain clarification of various aspects of the opinion below relating to the functions of a section 11(e) court vis-a-vis the Commission and the standard of valuation in simplification proceedings. Answers and cross-petitions were filed on behalf of two groups of common stockholders. The court below denied the prayers of the petitions and cross-petitions, stating that "neither the Commission, nor the district court, nor this Court possesses the power to waive the provision of section 11(e) providing for approval of a plan of reorganization as fair and equitable" (R. 139). It refused to treat the Commission's amendatory order

of February 11, 1947 or its approval of the escrow agreement as a rejection of Commission's statutory role—the order (according to the court below) being merely a device to expedite execution of the plan of reorganization after the requisite statutory approval. In view of its affirmance of the district court's disapproval of the plan as unfair and inequitable, the court below directed the Commission to reconsider the problem presented in the light of its opinion or "procure the review" thereof by this Court (R. 140).

Reasons for Granting the Writ.

The case at bar poses two major issues—the division of functions between the district court and Commission and the significance of the fair and equitable standard in simplification proceedings under the Act—which, together with several subsidiary questions, loom large in the proper administration of the Act. Both major issues directly affect the uniform and practicable enforcement of the Act and their resolution by the court below renders difficult the achievement of uniformity and imposes an impossible administrative burden upon the Commission in the performance of its duties under the Act. The decision of the court below is difficult to comprehend and impossible to apply. It has created confusion and complexity where none previously existed. Moreover, the rights of stockholders under other similar plans may be affected.

I.

1. The decision of the court below appears to be squarely in conflict with decisions of the Circuit Courts of Appeals for the First, Second and Eighth Circuits in respect to the scope of review by a section 11(e) court as to the fairness and equity of a plan. *Ladd* v. *Brickley*, 158 F. (2d) 212, 216 (C. C. A. 1, 1946) cert. den. 330 U. S. 816 (1947); *Lahti* v. *New England Power Ass'n.*, 160 F. (2d) 845, 850-1 (C. C. A. 1, 1947); *Public Service Commission of N. Y.* v. *S. E. C.*, 166 F. (2d) 784, 788 (C. C. A. 2, 1948); *Mitss. Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. (2d) 424, 430 (C. C. A. 8, 1945) cert. den. 327 U. S. 795 (1946). In the case at bar, the court below held "that a Section 11(e) court must exercise its full and independent judgment as to the fairness and equity of the plan" (R. 33) and that the findings and conclusions of the Commission are not binding upon it but should be treated "with respect". It refused to apply the substantial evidence doctrine to the Commission's findings and to hold that the Commission's conclusions may not be disturbed by a section 11(e) court unless they lack "rational or statutory foundation" or that the Commission's judgment may not be reversed by such court except for a clear abuse of discretion (R. 33, 34).[10] In the course of its opinion,

[10] The district judge's view in the instant case as to his "affirmative and independent duty" to consider the fairness and equity of the plan, which the circuit court has in substance adopted, is of relatively recent vintage, and does not square with his own earlier expressions and other decisions within the Third Circuit which are in accord with the majority doctrine of substantial evidence. *E. g., In re Central & South West Utilities Co.*, 66 F. Supp. 690, 692 (D. Del. 1946); *In re Standard Gas and Electric*

[Footnote continued on following page.]

the court below recognized its disagreement in this respect with other circuit courts, stating: "There are decided cases which look the other way and these are entitled to great consideration" (R. 31).

The contrary standard as indicated in the opinion below, has been enunciated in *Mass. Mutual Life Ins. Co.* v. *S. E. C.*, *supra*, where the Eighth Circuit Court said:

"Obviously, whether, upon retirement of out-

[Footnote continued from preceding page.]

Co., 59 F. Supp. 274, 283 (D. Del. 1945), reversed on other grounds, 151 F. (2d) 326 (C. C. A. 3, 1945); *In re United Light & Power Co.*, 51 F. Supp. 217 (D. Del. 1943). Thus in the *Standard Gas* case, *supra*, the same district judge said:

> "* * * Under the substantial evidence rule, we are required and should follow the 'informed' judgment as articulated in the Commission's findings.
>
> * * * *
>
> "Examination of testimony and documentary proofs presented to the Commission demonstrates manifestly there was substantial evidence to support the Commission's findings as to the value of the securities to be disfributed to the Noteholders under the plan. * * *"

In the same spirit, the Third Circuit Court of Appeals, although reversing in the *Standard Gas* case, *supra*, on a point of law, declared:

> "This case does not come to the court as the result of agreement between the parties or the action of a special master approving a plan in the common form of reorganization proceeding. It comes following a thorough consideration by the Securities and Exchange Commission which has a very broad grant of power from Congress in the premises.
>
> "It can be set out as a well established rule of administrative law that the action of an expert administrative body in determining the particular remedial measures demanded in an individual case is not to be overturned by court action unless the administrative body has lost sight of the law. The more technical the subject matter before the administrative tribunal, the more reluctant the court should be, we think, in disagreeing with it on a matter which is a question of judgment" [151 F. (2d) 331].

standing bonds in the reorganization * * * payment of principal, accrued interest, *and* redemption premiums is the equitable equivalent of the bondholders' rights depends upon the facts of each particular case. The proper measure of such equivalence is for the determination of the Commission in the first instance, and its expert skill in appraising the facts to be considered must be accorded due weight by the Court.

"Since there is a 'rational basis' in fact for the finding of the Commission and no 'clear-cut' error of law by either Commission or court, we are not inclined to disturb the conclusion that retirement of the bonds at principal and accrued interest amounts to the 'equitable equivalent of the rights surrendered.'" [131 F. (2d) 430].

Similarly in *Lahti* v. *New England Power Ass'n., supra,*[11] the First Circuit Court sustained the Commission's finding of equivalence saying:

"Appellants' real challenge is to the correctness of the finding by the Commission and the district court that the plan is fair and equitable to the persons affected by it. This finding cannot be upset by us unless it is shown to be without rational basis in fact or to be predicated on a clear-cut error of law.

* * * * *

"* * * We are here in the realm not of mathematical demonstration, but of forecast, based

[11] The district court in this same case [66 F. Supp. 378, 382 (D. Mass. 1946)], said:

"In truth, any court charged with a review of the findings of the Securities and Exchange Commission, in a matter so complex in its nature as is the present proceeding, should accept the findings of the expert body unless it concludes that an error of law has been committed or the findings are of an arbitrary or capricious nature."

upon expert analysis and weighting of a complex array of factors, in which the informed judgment of the Commission counts heavily. It could not be otherwise" [160 F. (2d) 850-1].

The same principle, although not as clearly articulated, appears to have been applied by the Second Circuit Court in the *Public Service Commission* case, *supra*,[12] where the court said:

> "* * * Whether there was any evidence to support the conclusion that the old common shares had any value, based upon the future earning power of the Kings County Company, is an inquiry into which we are not disposed to enter. Any opinion is at best a guess, dependent, among other things, upon what rates the Company will be allowed to charge. There was certainly some basis for the valuation of the SEC when the order of the District Court was entered on July 16, 1947" [166 F. (2d) 788].

Moreover, the standard of "'full and independent judgment'" established by the court below is in conflict with the applicable general principle of review that

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[12] The Second Circuit Court is apparently endorsing the doctrine as announced by the District Court in the same case [72 F. Supp. 767, 783 (S. D. N. Y. 1947)] in the following language:

> "As far as I am concerned, my duty is at an end when I find, as I do, that the action of the Securities and Exchange Commission was based upon findings supported by evidence, and was made pursuant to authority granted by Congress. I do not pretend to have either technical competence or legal authority to pronounce upon the wisdom of the course taken by either commission. *Board of Trade* v. *United States*, 1942, 314 U. S. 534, 548, 62 S. Ct. 366, 86 L. Ed. 432; *National Broadcasting Co.* v. *United States*, 1943, 319 U. S. 190, 224, 63 S. Ct. 997, 87 L. Ed. 344; both of which cases are cited in *Securities and Exchange Commission* v. *Chenery Corp.*, 67 S. Ct. 1575."

courts will uphold an administrative order, if based upon substantial evidence, and not arbitrary nor erroneous as a matter of law as recently reaffirmed by this Court in *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194, 208 (1947), and as continually applied in analogous situations.[13]

The second *Chenery* case, *supra*, expounds a doctrine of judicial review of administrative action, which, although deemed not controlling in the case at bar by the circuit court, we submit, is applicable here and at variance with the circuit court's position and affords the correct test of administrative action, whether judicial review occurs via section 11(e) as in the instant case, or via section 24(a)[14] of the Act as in the second *Chenery* case. In the language of this Court in the second *Chenery* case:

> "The scope of our review of an administrative order wherein a new principle is announced and applied is no different from that which pertains to ordinary administrative action. The wisdom of the principle adopted is none of our concern. * * * Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress. See *National Broadcasting Company* v. *United States*, 319 U. S. 190, 224. . .

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[13] For instance: *National Broadcasting Co.* v. *U. S.*, 319 U. S. 190, 224 (1943); *Rochester Telephone Corp.* v. *U. S.*, 307 U. S. 125, 139, 140, 145, 146 (1939); *U. S.* v. *Morgan*, 307 U. S. 183, 199 (1939); *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 473 (1943); *RFC* v. *Denver & Rio G. W. R. Co.*, 328 U. S. 495, 508-9 (1946); *Dobson* v. *Commissioner*, 320 U. S. 489 (1948).

[14] Section 24(a) of the Act [15 U. S. C. §79x(a)] provides in pertinent part as follows: "The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."

"We are unable to say in this case that the Commission erred in reaching the result it did. The facts being undisputed, we are free to disturb the Commission's conclusion only if it lacks any rational and statutory foundation. In that connection, the Commission has made a thorough examination of the problem, utilizing statutory standards and its own accumulated experience with reorganization matters. * * *

"* * * The 'fair and equitable' rule of §11(e) * * * [was] inserted by the framers of the Act in order that the Commission might have broad powers to protect the various interests at stake. * * * The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters" (332 U. S. 207-8).

Hence the scope of review of administrative action is no different, even where, assuming *arguendo*, as the court below suggests, the Commission has announced and applied a "new" "formula" of "investment value" in the evaluation of the rights surrendered in the simplification of a holding company system. Such action is entitled to the "greatest amount of weight", as it lies primarily in the informed discretion of the Commission and is a judgment, of the type which the Commission is especially equipped to make, being based upon statutory standards and its own accumulated reorganization experience. As stated in the second *Chenery* case: "The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight. * * *. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the

type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. * * * Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb" (332 U. S. 209).

Moreover, the decision of the court below is also at variance with, and sanctions the departure by the district court from, the customary standards of judicial review as codified in section 10(e)(B)(1) and (5) of the Administrative Procedure Act [60 Stat. 243, 5 U. S. C. § 1009(e)(B)(1) and (5)]. These codified rules, which have been held declaratory of existing law of judicial review,[15] require the reviewing court to "(B) hold unlawful and set aside agency action, findings and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" and "(5) unsupported by substantial evidence in any case * * * reviewed on the record of an agency hearing provided by statute". Instead of applying the foregoing codified standards to the Commission's action, the court below maintains that a section 11(e) court is entitled to exercise its own independent judgment in determining the fairness and equity of the plan.

2. A subsidiary question arises from the statement by the court below that a section 11(e) court may "receive evidence *aliunde* the Commission's record respecting the fairness and equity of a plan", and "may decide upon the new evidence and upon that contained in the Commission's record that the plan is unfair and inequitable and remand the proceeding

[15] *Olin Industries* v. *N. L. R. B.*, 72 F. Supp. 228 (D. Mass. 1947).

to the Commission for further consideration". Such unlimited reopening of the administrative record for the receipt of additional evidence is fraught with danger as it permits in effect a trial *de novo* by the district court and is contrary to the rule uniformly and generally applied by the courts in other circuits to section 11(e) proceedings under the Act[16] and implicitly recognized in the cases applying the substantial evidence rule (*supra*, at p. 17). Thus in *In re Electric Bond and Share Company, supra,* the district court said, in quoting from the case of *In re Laclede Gas Light Co., supra*:

> "* * * we can see no more reason for permitting evidence to be offered, other than the record made before the Commission in a hearing under Section 11(e) than in a hearing under Section 24(a) of the Act, and especially do we believe this should be the rule when the Court of Appeals may "modify" or "set aside" order of the Commission "in whole or in part" and yet is restricted in the receipt of evidence, solely to send the case back to the Commission to hear such additional evidence. A reasonable interpretation of the Act does not permit a more liberal rule on hearing additional testimony in a case before the Court under Section 11(e) than under Section 24(a) of the Act." (73 F. Supp. 443).

3. In sanctioning the substitution of the district court's judgment for that of the Commission, the disregard of the Commission's findings and the reopening of the administrative record, the decision of the

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[16] *In re Electric Bond & Share Co.*, 73 F. Supp. 426, 443 (S. D. N. Y., 1946); *In re Laclede Gas Light Co.*, 57 F. Supp. 997, 1002 (E. D. Mo., 1944), aff'd *sub nom. Massachusetts Mutual Life Ins. Co. v. S. E. C.*, 151 F. (2d) 424 (C. C. A. 8, 1945), cert. den. 327 U. S. 795; *In re Jacksonville Gas Co.*, 46 F. Supp. 852 (D. Fla., 1942).

court below, relegates the Commission to a position of comparative insignificance and distorts the legislative division of functions between the Commission and the district court. Cf. *Scripps Howard Radio* v. *F. C. C.*, 316 U. S. 4, 11 (1942). Such distortion of the statutory scheme results from a mistaken rejection of the doctrines of substantial evidence and administrative finality. Yet the Commission's action, when tested by every theoretical and practical reason for administrative finality, is entitled to the highest credit in the courts—its independence, expertness, procedures, staffing, the complexity of the subject, etc.

Furthermore, the consideration of a uniform and expeditious administration of the Act requires that the Commission be given all the credit to which it is entitled under the law and that its decisions receive identical treatment. The dispersal of section 11(c) enforcement proceedings to district courts all over the country tends inevitably to produce conflicting decisions[17] and the concomitant lack of uniformity, particularly if every district court is given the power to substitute its judgment for that of the Commission. Uniform application of the Act can only be accomplished by the coordination of the standards of review under section 11(e) and section 24(a) on the basis of the substantial evidence rule and the doctrine of administrative finality as enunciated by this Court.

[17] It is not inconceivable that such a conflict as suggested in the instant case might lead to a stalemate and a consequent frustration of Congressional intent.

II.

The opinion of the court below is in conflict in several respects with the applicable decisions of this Court, particularly *Otis & Co.* v. *S. E. C.*, 323 U. S. 624 (1945), and *Schwabacher* v. *United States*, 334 U. S. 182 (1948).[18] Paying lip service merely to the *Otis* principles, the court below has in reality strayed far afield from the rules established by this Court and has enunciated the following conflicting doctrine in evaluating the rights surrendered upon simplification under section 11(e) of the Act:

> "* * * All pertinent factors and all substantial equities must be considered by the Commission whether equitable equivalents are to be reached by the approach *ex* the Act or the approach *intra* the Act. The new doctrine of investment value presently urged by the Commission may not be substituted for the doctrine of equitable equivalents enunciated in the *Otis & Co.* decision" (R. 38).

1. These criteria, apart from their nebulous and ambiguous character, represent only a mirage of consistency with this Court's views and in reality, reject the conception that the phrase "fair and equitable" as used in section 11(e) of the Act imports the principle of full priority as developed in the receivership and bankruptcy reorganization cases. In place of the principle of full priority, the court below proposes a variable and uncertain theory of "all pertinent factors and all substantial equities"—apparently simi-

[18] In a letter dated May 11, 1948, during the pendency of the rehearing, General Counsel of the Commission drew the circuit court's attention to the *Schwabacher* case decided on May 3, 1948, by this Court.

lar to the principle of "colloquial equity"[19] by which the district court in the instant case sought to measure the participation of the security holders. Such non-technical significance of the phrase "fair and equitable", resulting as it does in a substitution of indefinite considerations for the well-defined rights of the security holders, is entirely at variance with the technical definition of that expression, as words of art, in the *Otis* and *Schwabacher* cases which require that full priority in treatment be accorded various classes of security interests—creditors and stockholders and various classes of stockholders *inter sese*,—so that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered. The entire bundle of rights must be determined as though in a continuing enterprise—a going concern apart from the pending reorganization. These principles are announced by this Court in the *Otis* case in the following terms:

> "Like the bankruptcy and reorganization statutes, the Public Utility Holding Company Act, in providing that plans for simplification be 'fair and equitable', incorporates the principle of full priority in the treatment to be accorded various classes of security interests. This right to priority

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[19] This standard of colloquial equity has been articulated, on several other occasions in addition to the instant case by the same district court, *e. g., In re Community Gas & Power Co.*, 71 F. Supp. 171 (D. Del. 1947); *In re Cities Service Co.*, 71 F. Supp. 1003 (D. Del. 1947). In *In re United Light and Power Co.*, 51 F. Supp. 247 (D. Del. 1943), which eventually became the *Otis* case, the same district court announced a similar view, suggesting that the "expression 'fair and equitable' should be given its ordinary non-technical meaning". Despite the district court's statement as to the application of the standard of colloquial equity in the *Otis* case neither this Court nor the circuit court adopted any such nebulous theory.

in assets which exists between creditors and stockholders, exists also between various classes of stockholders. When by contract as evidenced by charter provisions one class of stockholders is superior to another in its claim against earnings or assets that superior position must be recognized by courts or agencies which deal with the earnings or assets of such a company. Fairness and equity require this conclusion. * * * This is the rule applied by the Commission in the simplification of corporate structure. The Commission recognizes and applies the doctrine of full priority by giving value to the rights of the preferred in a going concern rather than as if by sale and distribution * * *" (323 U. S. 634-5).

This *Otis* doctrine, it should be noted, has recently been reaffirmed in the *Schwabacher* case where this Court said:

"In construing the words 'fair and equitable' in a federal statute of very similar purposes, we have held that although the full priority rule applies in liquidation of a solvent holding company pursuant to a federal statute, the priority is satisfied by giving each class the full economic equivalent of what they presently hold, and that, as a matter of federal law, liquidation preferences provided by the charter do not apply. We said that, although the company was in fact being liquidated in compliance with an administrative order, the rights of the stockholders could be valued 'on the basis of a going business and not as though a liquidation was taking place'. Consequently the liquidation preferences were only one factor in valuation rather than determinative of amounts payable. *Otis & Co.* v. *Securities & Exchange Commission*, 323 U. S. 624" (334 U. S. 199).

2. Moreover, reference to various "factors" and "equities" which, in the opinion of the court below, merit special consideration, reveals further deviations from the applicable decisions of this Court. Thus, the court below requires the Commission to consider and weigh into the calculation "substantial losses which occurred to Engineers by virtue of divestitures compelled by the Act".[20] Even assuming *arguendo* that these losses can be traced and attributed to the operation of the Act, this requirement is not only in conflict with the *Otis* principle of "full priority" as indicated above but, in compelling a re-examination of divestments and other transactions executed pursuant to the Act, it constitutes a collateral attack in violation of the salutary policy underlying the doctrine of *res judicata,* upon final decisions, such as the *Puget Sound* divestment, in which the plan proposed by a common stockholder management has already been enforced by the United States District Court for the

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[20] After disposing of Engineers' insubstantial contention to restrict the preferred to $100 because of the alleged *Puget Sound* "loss", supposedly caused by the Act, the Commission commented:

> "In passing, we should point out that we do not accept counsel's hypothesis that the *Act* has caused the asserted losses. In all of its divestments, Engineers has been free in its choice of methods, and, within limits, to choose the time for divestment. All sales have been negotiated by Engineers at arm's-length. If, as in the case of *Puget Sound*, the sale brought less than the carrying value on the books of Engineers, the indication is that the carrying value was excessive and not that the sales price was low. It is significant that the market price of Engineers' common when the plan was filed was the highest since 1932 and that the price has been rising steadily since 1942 when the program of simplification got under way. As shown in Footnote 45, *supra*, Engineers' common reached a low of 1⅛ in 1935. By 1945, when the plan was filed, it had reached a high of 37" (R. 72a, fn. 55).

District of Massachusetts.[21] Such suggested re-examination clearly flies in the face of the well-settled doctrine of *res judicata* as enunciated in the recent cases of *Commissioner* v. *Sunnen*, 333 U. S. 586 (1948) and *Sherrer* v. *Sherrer*, —— U. S. ——, 92 L. Ed. 1055 (1948).

Furthermore, the effect of weighing the alleged losses arising from divestments for the benefit of the common, as the court below directs, results in substance, in the subordination of the claim of the preferred to that of the common to the extent of such losses, even though the history of Engineers reveals no "spoliation, mismanagement and faithless stewardship" by the preferred. The voting common, not the preferred, have occupied a position of complete control. Accordingly, the subordination of the preferred stockholders would constitute a misapprehension and misapplication of the "Deep Rock Doctrine", as recently restated in *Comstock* v. *Institutional Investors*, —— U. S. ——, 92 L. Ed. 1360, 1370 (1948), citing *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, 83 L. Ed. 669 (1939) and *Pepper* v. *Litton*, 308 U. S. 295, 84 L. Ed. 281, 290 (1939). Nor do the public preferred stockholders in the instant case fall within the ban of the principle established by the Commission and sustained by this Court in *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194 (1947), under which management insiders are limited to cost on their purchases of securities during a reorganization.

Other "factors" and "equities" to be considered in view of the circuit court's affirmance of the district

[21] *Puget Sound Power & Light Co.*, 13 S. E. C. 226 (1943), plan approved and enforced, civil action No. 2308 (D. Mass. 1944).

court's views, although not expressly mentioned in the opinion below, are, in the language of the district court, the so-called "past sacrifices and contributions of the common", including such historical "factors" and "equities", as issue prices, market prices, brief period of dividend omission, retained earnings, etc. This approach involves a shift in emphasis to factors entitled under the decisions to but little weight and away from elements, such as current rights to earnings and assets which are entitled to primary weight. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U. S. 523 (1943); *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 632 (1945); *Lahti* v. *New England Power Assn.*, 160 F. (2d) 845 (C. C. A. 1, 1947); *Phillips* v. *S. E. C.*, 153 F. (2d) 27 (C. C. A. 2, 1946), cert. den. 328 U. S. 860 (1946). It in effect, seeks to restore "values * * * already lost under the operation of economic forces" contrary to the principle proclaimed as follows in the *Schwabacher* case:

> "* * * Public regulation is not obliged and we cannot lightly assume it is intended to restore values, even if promised by charter terms, if they have already been lost through the operation of economic forces. Cf. *Market Street R. Co.* v. *Commission*, 324 U. S. 548. In appraising a stockholder's position in a merger as to justice and reasonableness, it is not the promise that a charter made to him but the current worth of that promise that governs, it is not what he once put into a constituent company but what value he is contributing to the merger that is to be made good" (334 U. S. 199).

Accordingly, the circuit court's rejection of the technical definition of "fair and equitable" as embodying the principle of "full priority" described above

and its application of the standard of "all pertinent factors and all substantial equities" constitute a misconception of the *Otis* case and are at variance with the *Otis* and *Schwabacher* cases. Moreover, its substitute criteria, under which the extent of participation is measured by irrelevant factors extrinsic to the contract rights of the security holders, affords no rational basis for the administration of the Act upon a uniform national basis and will necessarily create a lack of uniformity in view of its dependence upon determinations of the weight of various intangible factors by different enforcement courts all over the country.

3. The court below also states that "No particular, specific approach [to the problem of valuation] is to be nailed to Commission's head" and suggests that an approach either "*intra* the Act" or "*ex* the Act" could "lead to just and appropriate valuations". Such choice of alternative methods of valuation is erroneous and contrary to the opinions of this Court in the *Otis* and *Schwabacher* cases. The approach "*intra* the Act" requiring valuation as if the liquidation pursuant to the Act falls within the coverage of the charter liquidation provisions would violate the *Otis* rule of "inoperativeness" as enunciated in the following statement from this Court's opinion:

> "* * * We think, however, the charter preference is inoperative in simplification under §11(b)(2). The provision having been adopted in 1929, six years prior to enactment of the Public Utility Holding Company Act, a 'simplification' under this Act, having as an incident to it the dissolution of one company in a holding company system, was not an anticipated 'liquidation' within the meaning of Power's charter provision. * * * The Commission in its enforcement of the

policies of the Act should not be hampered in its determination of the proper type of holding company structure by considerations of avoidance of harsh effects on various stock interests which might result from enforcement of charter provisions of doubtful applicability to the procedures undertaken. Where pre-existing contract provisions exist which produce results at variance with a legislative policy which was not foreseeable at the time the contract was made, they cannot be permitted to operate. * * *" (323 U. S. 634-8).[22]

Moreover, the foregoing interpretation of "*intra* the Act" would appear to be inconsistent with the circuit court's statement that the charter provisions are "not dispositive of the issues presented".[23] But even assuming the proper application of the *Otis* rule of "inoperativeness" in view of the circuit court's express statement in this connection, the phrase "*intra* the Act" would seem to imply valuation "as if the Act had been passed" or the converse of the phrase "*ex* the Act", as defined in at least one place in the opinion of the court below to mean "as if the Act had *never* been passed". A literal application of this interpretation would involve the reconstitution of Engineers' assets by recording and appraising the effects of the operation of the Act for the past 10 years upon the Engineers' system and possibly the whole public utility industry. Since such reconstruction is at variance with the applicable decisions of this Court, imposes an impossible administrative burden upon the Commission, and is based upon a misconception by the court below of the significance of the phrase "*ex* the Act", as will be demonstrated *infra* at p. 35

[22] Engineers was incorporated in Delaware in 1925 (R. 1403a).
[23] R. 34.

ff., this definition of "*intra* the Act" must necessarily be found to be erroneous.

It may be that the above interpretation of the expression merely harks back to the following quotation from the opinion of the district court to which the court below refers as "the greatest difference between the respective approaches of the court and the Commission to the problem of valuation":

> "'I do not consider the argument advanced [by the Commission] as to what these series of preferreds would be worth if there were no Public Utility Holding Company Act. I do not think it profitable to consider an argument based on unreality *for there is a Public Utility Holding Company Act.* Unless one subscribes completely to the doctrine of foreordination things might always be different from what they are.'" (R. 20).

Under such view, an appraisal "*intra* the Act" would require the rights of the security holders to be measured in terms of the situation created by the statute, *i. e.*, as though a liquidation were taking place and not in terms of the situation terminated by it.[24]

[24] This statement is the converse of a quotation from the opinion of the Commission in *United Light and Power*, H. C. A. R. No. 4215 p. 13 [13 S. E. C. 12] (1943), which appears as follows in the opinion of this Court in the *Otis* case:

> "'Under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—*i. e.*, as though no liquidation were to take place. In this way each class of stock will be accorded its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system.'" (323 U. S. 635, fn. 17).

Accordingly, this concept runs counter to the *Otis* case under which the preferred and the common were given the equivalent of their participation "as though in a continuing enterprise instead of in liquidation".

It is clear that, under the *Otis* case, contrary to the above implication of "*intra* the Act", as used by the court below, one class of security holders is not permitted to take advantage of a situation created by Congress to secure a benefit at the expense of the other, and both are held to the value of their bargains *inter sese* without reference to the liquidation or reorganization process in accordance with the policy expressed as follows in the *Otis* case: "Enforcement of an overriding public policy should not have its effect visited on one class with a corresponding windfall to another class of security holders" (323 U. S. 637).

In short, the approach "*intra* the Act" does not under any conceivable interpretation establish a sound standard for determining equitable equivalents and is also inconsistent with the views of this Court as indicated above. In any event, it is nowhere explained with sufficient clarity to provide the Commission with an adequate guide for valuation. Indeed the attempts by appellants (including petitioners herein) to secure clarification on rehearing by the court below, were unavailing (R. 140).

4. The alternative approach "*ex* the Act" signifies in the opinion of the court below valuation "as if the Act had never been passed". This significance of "*ex* the Act" appears to require an historical review of the past 10 years' activities in the Engineers' system and the public utility industry, with an eye toward the elimination of the effects of the Act and

the reconstruction of Engineers on that basis.[25] A retroactive readjustment of benefits and detriments (or profits and losses) so as to eliminate the effects of numerous orders of the Commission, interspersed among a variety of independent and possibly unrelated causal factors as the economic, political and scientific forces of the times, creates an infinite assignment impossible of fulfillment, and imposes an overwhelming burden upon the Commission, in its administration of the Act. Furthermore, such re-examination represents a collateral attack upon final judicial and administrative decisions in disregard of the doctrine of *res judicata*, as indicated above. Lastly, this valuation "*ex* the Act", predicated upon the aforesaid historical analysis, is not reconcilable with the "current worth" rule of the *Schwabacher* case and the "going concern" doctrine of the *Otis* case. In other words, the phrase "*ex* the Act" must mean "apart from the reorganization compelled by the Act", or "on the basis of a going business and not as though a liquidation were taking place", in the language of the *Otis* case as applied by the Commission, and cannot possibly be construed to mean "as though the Act had never been passed", the approach suggested by the court below. As this Court said in the *Otis* case:

> "We reach the conclusion that the Securities and Exchange Commission applied the correct rule of law as to the rights of the stockholders inter sese. That is to say, when the Commission proceeds in the simplification of a holding company system, the rights of stockholders of a solvent company which is ordered by the Commission to distribute its assets among its stock-

[25] Converse of the interpretation of "*intra* the Act" discussed at pp. 33-35 of this Petition.

holders may be evaluated on the basis of a going business and not as though a liquidation were taking place" (323 U. S. 633).

5. In addition, the court below criticizes the Commission for its alleged disregard of what it conceives to be a substantial difference between the instant case and the *United Light and Power* reorganizations, namely, the termination of the holding company enterprise both for the preferreds and the common in the former[26] and the continuance of the holding company enterprise in the latter, there being merely a shift of "the security holder participation in the enterprise from the top holding company * * * to a subsidiary holding company". Thus the court below approves the district court's valuation in the instant case "of the securities '*ex* the Act', considering the holding company enterprise to be at an end, as it is in fact" (R. 36).

In the first place the attempted distinction overlooks this Court's admonition in the *Otis* case that "The reason [for its decision] does not lie in the fact that the business of Power continues in another form". Secondly, the statement of the court below when carried to its logical conclusion results in improper emphasis upon the procedural sequence of simplification, even though, as this Court has said in the *Otis* case, values should not "be made to depend on whether the Commission, in enforcing compliance with the Act, resorts to dissolution of a particular company in the holding company system, or resorts instead to the device of merger or consolidation". Procedural deci-

[26] In contrast, the district judge considered the *Otis* rule to apply to a situation in which there is a true liquidation rather than a nominal or formal liquidation (R. 288, fn. 2).

sions, such as the selection of a particular sequence in or method of system adjustment (especially since in the case at bar the choice has been made by the common stock management of Engineers[27]), should not affect rights.[28] So said this Court as follows in the *Otis* case:

> "* * * Satisfaction of the great-grandfather clause might have been obtained in this or other holding company systems by an order for merger, consolidation or recapitalization between top holding companies or between associate companies in the lower tiers of the corporate hierarchy. Such procedure would avoid the liquidation of Power. * * * The selection by the Commission of one method of system adjustment to accomplish simplification rather than another is an incident which ought not to affect rights" (323 U. S. 631).

6. The court below, having apparently misconceived the meaning of "*ex* the Act," as indicated above, unjustly censures the Commission for allegedly adopting inconsistent techniques or methods in valuing the preferreds "*ex* the Act" and the common "*intra* the Act". In reality the Commission valued both the common and preferreds "*ex* the Act" or apart from the reorganization in accordance with the principles enunciated in the *Otis* case. Applying the doctrine of full priority, the Commission first valued the preferreds, and consequently, in valuing the preferreds apart from reorganization or on a going concern basis, necessarily reciprocally valued the com-

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[27] R. 718a, 719a.

[28] Under section 11(e) of the Act the choice of an appropriate method of compliance from available alternatives is left by the Commission to the company or as in the instant case to the common stock management of Engineers. *Commonwealth & Southern Corp.* v. *S. E. C.*, 134 F. (2d) 747, 751 (C. C. A. 3, 1943).

mon, by the same standard. In other words, since the total enterprise is to be divided between two claimants, the preferreds and the common, once the preferreds have been valued on a going concern basis and that value subtracted from the total, it appears obvious that the residual value is thereby established for the common, on the same basis. The preferreds are entitled, according to the Commission, to amounts equal to their redemption prices as the equitable equivalents of the rights surrendered,[29] and the common entitled, in exchange for their rights, to the remaining assets or the securities in the operating companies, there being no need to place a dollar value on the securities thus received in exchange.[30]

The Commission, in determining fair and equitable treatment for the preferred in the instant case, has applied the usual technique in valuing senior securities, such as bonds, upon retirement unaccompanied by the liquidation or dissolution of the particular holding company.[31] In both situations, namely, the

[29] Common stock management selected the type of distribution (*i. e.*, cash for the preferreds and underlying securities for the common). The preferreds were not permitted to participate or retain a stake in the continuing enterprise in any form whatsoever (including the underlying securities) as the common stock management wanted to retire or treat the preferreds otherwise (R. 719a).

[30] Full compensatory treatment may properly be made in either cash or securities by both the I. C. C. and the Commission. *Standard Gas & Electric Co.*, 151 F. (2d) 326 (C. C. A. 3, 1945); *Georgia Power & Light Co.*, H. C. A. R. No. 5568, plan enforced (M. D. Ga. 1945); *New York, N. H. & H. R. Co.*, 147 F. (2d) 407, 47 (C. C. A. 2, 1945), aff'g 54 F. Supp. 595, cert. den. 325 U. S. 884 (1945); *Chicago Railways Co.*, 160 F. (2d) 59 (C. C. A. 7, 1947).

[31] The analogy is clear when the Engineers' plan is viewed as embracing two separate phases or transactions, (1) the retirement of the preferred stock; and (2) the subsequent dissolution of Engineers, resulting in the distribution of securities in the underlying operating companies to the common stockholders.

elimination of the preferred in the instant case and the retirement of bonds, a dollar value is placed upon these senior securities, while the junior securities or the common stock receive the residual value, consisting of securities in the operating companies as in the instant case, in view of the dissolution of Engineers. The same result is achieved by the common stockholders' acquisition of the complete ownership of the holding company enterprise in the situation where retirement of the senior securities occurs without dissolution.[32] Therefore the circuit court's criticism that the Commission "made no finding as to the 'value' of the common stock" is without substance,[33] for the Commission merely did not place a dollar sign on the rights surrendered by the common[34] but has expressly found that the "plan is fair to the common stockholders" and that the "retirement of the preferred stock will be of immediate benefit to the common stockholders". Hence the Commission has determined that the residual value of Engineers, namely the securities in the operating companies received in exchange, is the equitable equivalent of the rights surrendered by the common. In such a case a distribution may properly be made without dollar valuation. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. R. Co.*, 318 U. S. 523, 565 (1943); *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 482 (1943); *Otis & Co.* v. *S. E. C.*, 323 U. S. 624

[32] A dissolution of a holding company means little more than the receipt of securities in the operating company in lieu of the present shares in the holding companies. *American Power and Light Company* v. *S. E. C.*, 329 U. S. 90 (1946).

[33] No such absence of a finding of value for the common was mentioned by the district judge.

[34] As stated in the *Standard Gas* case: "Actually it was not incumbent upon the Commission to reduce the result to dollars and cents in the process of valuation" [151 F. (2d) 333, n. 12].

(1945). A requirement that dollar values be put upon the rights surrendered and the *quantum* received "would create an illusion of certainty where none exists and would place an impracticable burden upon the entire simplification process." Practical adjustments are required rather than a rigid formula. Accordingly, such determination need not be made by the use of any mathematical formula or with mathematical certitude. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. and P. R. R. Co.*, *supra*, at pp. 565-6.

7. In addition the court below finds fault with the Commission for attempting to substitute "the new doctrine of investment value * * * for the doctrine of equitable equivalents enunciated in the *Otis & Co.* decision";[35] and maintains that "investment value is and can be only one of a series of factors to be used in arriving at equitable equivalents." Even assuming

[35] Certainly novelty is not revealed in the following rationale in the Commission's decision in the instant case:

> "It is settled that in a Section 11 reorganization a security holder must receive, in the order of his priority, from that which is available for the satisfaction of his claim, the equitable equivalent of the rights surrendered. Since under the circumstances of this case, we do not think it proper to regard the liquidation provisions of the charter as conclusive in determining those rights, we must consider all provisions of the charter applicable to the preferred, such as the dividend rate and the call price as well as the liquidation preferences, and we must analyze the financial condition of the company with particular regard to the asset and earnings coverage of the preferred" (R. 62a).

After reviewing the financial data and expert testimony the Commission concluded:

> "It is apparent that the preferred has an investment value at least equal to the respective call prices. * * *

[Footnote continued on following page.]

arguendo that the Commission has by its decision herein announced and applied a novel principle of valuation, such action is not forbidden and is entitled to the greatest weight since it reflects the informed expert judgment of the Commission and is the "product of administrative experience, appreciation of the complexities of the problem, realization of statutory policies and responsible treatment of uncontested facts." *S. E. C. v. Chenery Corp.*, 332 U. S. 194, 209 (1945). Yet despite the statement of the court below, novelty cannot be ascribed to the investment value doctrine in view of its recognition by this Court in the *Otis* case. There it was pointed out that once it is concluded, as it has been here, that the dissolution results in a type of liquidation entirely distinct from the liquidation envisaged by the charter provisions, the Commission is permitted "to examine the investment values of the common and preferred stockholders". In reality the doctrine of investment value connotes no novel technique but reflects the measure of the stockholders' rights determined in the simplication of a holding company system on the "basis of a going business", as recognized in the *Otis* case.

[Footnote continued from preceding page.]

"Upon a full consideration of the record * * * the fair and equitable standard would require the payment [to the preferred] of an amount equal to the call prices of the securities, plus accrued dividends" (R. 67a-68a).

This latter quotation is to be contrasted with the following statement from the opinion of the court below:

"* * * We conceive that the Commission could make a finding under certain circumstances that investment value was the equitable equivalent to the security holder. The Commission in the instant case, however, has not made such a finding * * *" (R. 38).

It should also be noted that the district court does refer to the Commission's finding of the investment value of the preferreds (R. 299a).

It has been a settled principle at least since the *United Light & Power Co.*, 13 S. E. C. 1 (1943)[36] (the original *Otis* case) and recently reaffirmed in another aspect of that simplification,[37] that the present investment worth of a security, based on the bundle of rights surrendered, must be the measure of its participation in a section 11(e) plan. In short, present investment value or worth is not a substitute for equitable equivalent but its measure. It is not "one of a series of factors" to be used in valuation, but is the end result, the final product of the valuation process based on the bundle of rights surrendered and reflecting the earning power, market history, dividend record, asset priorities, and all other relevant factors. Such criteria provide a proper basis of valuation. *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526 (1941).

8. A further criticism is directed by the court below at the Commission on the basis of the *DuBois*, the *Group of Institutional Investors*, and the *Otis* cases for its failure "to give any substantial consideration to the future earning power of Engineers and its subsidiaries", and its neglect "to ascertain the future earning power of the system" or "apportion earning power between the preferreds and common based upon

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[36] In the words of the Commission: "It is our conclusion that we must judge the fairness of the plan according to legitimate investment values existing apart from the duty of liquidation imposed by the statute" (13 S. E. C. 11) The Commission then proceeds to a discussion of the "bundle of rights" affecting normal value.

[37] *United Light & Power Co.*, H. C. A. R. No. 6603 (1946).

their respective claims to income".[38] Reference to these cases reveals that in each, the reorganization involved the formation of a new corporation and the appropriate allocation of the securities therein on the basis of the apportionment of the earning capacity among the claimants. Hence earning capacity was projected far into the future and ascertained in order to insure the ability of the new corporation to meet the interest and dividend requirements of the new securities "as a *sine qua non* to the determination of the integrity and practicability of the new capital structure", and in order to avoid the "indefensible participation of junior securities in plans of reorganizations" in violation of the well established "absolute priority" rule.[39] It would therefore seem that the criticism of the court below reflects a misapplication of the principle of these cases since the instant case, in contrast to the decisions cited by the court below, does not involve the formation of a new corporation upon the dissolution of Engineer's nor consequently the allocation of securities therein nor the "indefensible participation of junior securities". Accordingly, the criterion of earning capacity which was originally fashioned as a shield to protect the preferred from "indefensible participation" of the common in a new corporation "in satisfaction of the absolute priority rule" has by the court below been converted improperly into a weapon in the hands of the

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[38] Apparently the district court disagrees with the circuit court in this respect as the district court nowhere in its opinion refers to any inadequate consideration of earning power.

[39] *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 525-6 (1941).

common against the preferred in disregard of the aforesaid rule. In effect the court below has attempted to restrict the preferred by its misapplication of the doctrine of full priority. Moreover, in view of the differences between the instant case and the cases cited by the court below in support of its criticism, there is no need for a hypothetical projection into the indefinite future of the earning capacity nor for an apportionment thereof. Where, as here, a careful study indicates the amplitude of earnings coverage for the preferred, it does not appear necessary to go further as the common's claims to income would be subordinate to those of the preferred stockholders. "The extent and method of inquiry necessary for a valuation based on earning capacity are necessarily dependent on the facts of each case." *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 527 (1941).

Conclusion.

The views of the courts below tend to cause confusion and enlarge the areas of uncertainty and dispute with respect to the powers and jurisdiction of the district court *vis-a-vis* the Commission, as affecting the fair and equitable standard and the scope of review in the simplification process. Appropriate guides to valuation must be provided and a proper allocation of function between court and agency made. The expeditious and uniform administration of the Act is at stake.

For the reasons stated, this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit should be granted.

Dated: New York, N. Y., August 16, 1948.

Respectfully submitted,

LAWRENCE R. CONDON,
Attorney for Petitioners,
Thomas W. Streeter, et al.,
preferred stockholders of
Engineers Public Service
Co.,
165 Broadway,
New York 6, N. Y.

LAWRENCE R. CONDON,
MILTON MAURER,
Of Counsel.